

GAO

Report to the Chairman, Subcommittee  
on Readiness, Committee on Armed  
Services, House of Representatives

November 1992

# AIR FORCE DEPOT MAINTENANCE

## Improved Pricing and Financial Management Practices Needed



147970

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United States  
General Accounting Office  
Washington, D.C. 20548

Accounting and Financial  
Management Division

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The Honorable Earl Hutto  
Chairman, Subcommittee on  
Readiness  
Committee on Armed Services  
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we review the Air Force depot maintenance industrial fund which has now been incorporated into the Defense Business Operations Fund.

The Air Force depot maintenance industrial fund has not recovered the costs it incurred in providing goods and services to customers. As a result, it reported losses totaling \$250 million for fiscal years 1988 through 1991. The Air Force's financial systems also did not contain reliable data on how much it should and does cost to perform depot maintenance work. Our report discusses these problems and contains recommendations for corrective actions.

We are sending copies of this report to the Secretaries of Defense and the Air Force, the Commander of the Air Force Materiel Command, the Director of the Office of Management and Budget, and interested congressional committees. Copies will be made available to others upon request.

This report was prepared under the direction of David M. Connor, Director, Defense Financial Audits, who may be reached on (202) 275-7095 if you or your staff have any questions. Other major contributors are listed in appendix II.

Sincerely yours,

Donald H. Chapin  
Assistant Comptroller General

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# Executive Summary

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## Purpose

The Air Force's Depot Maintenance Industrial Fund (DMIF), which sold about \$3.6 billion of maintenance services to its customers during fiscal year 1991, is supposed to break even on these sales. However, DMIF lost about \$250 million during fiscal years 1988-91. In addition, the backlog<sup>1</sup> of work it carried forward from one fiscal year to the next increased by half a billion dollars during this 4-year period. After several years of losses, DMIF reported a \$150 million profit for the 18-month period ending March 31, 1992.

The Chairman, Subcommittee on Readiness, House Committee on Armed Services, asked GAO to (1) determine the reasons for DMIF's losses, (2) evaluate the actions taken to eliminate them, (3) determine if DMIF customers' fiscal year 1993 budget requests include funds for work that is unlikely to be accomplished until fiscal year 1994, and (4) determine if the Air Force has an effective plan for implementing a Department of Defense (DOD) initiative to reduce depot maintenance costs.

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## Background

The Air Force Materiel Command (AFMC) uses DMIF to finance the Air Force's in-house and contract depot maintenance operations.<sup>2</sup> Most in-house services are performed by Air Force employees at five major depots, while contract services are performed by commercial repair sources and other DOD components. In fiscal year 1991, DMIF's in-house and contract operations had revenues of \$2.5 billion and \$1.1 billion, respectively.

DMIF relies on sales revenue rather than direct congressional appropriations to finance depot maintenance services. It does this by (1) using its working capital to finance the cost of doing work, (2) charging customers an amount that approximates the costs it expects to incur in doing the work, and (3) using customers' payments to finance subsequent operations.

DMIF's primary customers are Air Force commands that use Operation and Maintenance funds to purchase depot maintenance services, such as the overhaul of aircraft. These Operation and Maintenance funds are appropriated annually by the Congress and are available to support

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<sup>1</sup>The backlog equals the estimated cost to complete on-going work plus the price of funded work that has not been started.

<sup>2</sup>AFMC replaced the Air Force's former Logistics and Systems Commands on July 1, 1992. In this report, the abbreviation AFMC will also be used to refer to the Logistics Command, which was responsible for depot maintenance operations prior to July 1992.

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obligations incurred during a fiscal year. However, the funds may be used after this 1-year period to pay for work that was requested but not completed prior to the end of that year.

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## Results in Brief

DMIF suffered losses and experienced a steady increase in its backlog of work primarily because DMIF managers repeatedly based the fund's prices and the size of its work force on productivity estimates that were not attained. To eliminate the losses and achieve profits, DMIF has resorted to improper or questionable practices, such as charging customers for work that was not performed. These practices (1) cause financial reports and budget documents to provide a misleading picture of DMIF's performance and (2) make it difficult for DOD and the Congress to exercise their oversight responsibilities over DMIF and the appropriation requests of DMIF customers.

GAO's analysis of DMIF's projected work loads and capabilities for fiscal years 1992 and 1993 showed that DMIF customers' fiscal year 1993 budget requests include at least \$365 million for work that is unlikely to be started prior to fiscal year 1994. Also its analysis of the Air Force's plan for reducing DMIF's fiscal year 1991-95 costs by \$1.1 billion showed that the Air Force is unlikely to achieve these savings, primarily because (1) DMIF managers do not have the information they need to manage effectively and (2) the Air Force's plan makes unrealistic assumptions about the savings that can be achieved through competition.

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## Principal Findings

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### Productivity Goals Were Not Achieved

The Air Force has not corrected the problem that was the primary cause of not only DMIF's losses but also a growing backlog of unfinished work. GAO's analysis showed that this problem—the DMIF work force's lower than projected productivity—will probably continue during fiscal years 1992 and 1993, because DMIF managers used overly optimistic productivity assumptions in their budget estimates for these years. DMIF managers informed GAO that their work force's productivity has been adversely affected by frequent changes in the size and mix of the work load. They also told us of the difficulty they have in adjusting the work force to meet these work load changes. In their opinion, if they are expected to operate DMIF in an efficient and businesslike manner, then they should be allowed

to develop personnel policies and practices that make it easier to hire and release employees in response to changing work loads.

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### Growing Backlog of Work Has Budget Implications

DMIF's backlog of work grew from \$843 million at the end of fiscal year 1987 to \$1,348 million at the end of fiscal year 1991. Some "carryover" work is needed to ensure a continuous flow of work through DMIF maintenance shops between fiscal years. However, beyond this amount, there is little point in giving DMIF customers funds for work that cannot realistically be accomplished until well into the next fiscal year. GAO used Air Force estimates of (1) DMIF's backlog at the end of fiscal year 1991, (2) expected levels of customer orders and work force productivity, and (3) the optimal level of carryover work to determine that DMIF customers' fiscal year 1993 budget requests could be reduced by at least \$365 million without affecting either the amount of work DMIF completes or the efficiency of its operations.

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### Customers Not Billed for Work Performed

DMIF lost about \$93.4 million during fiscal years 1990 and 1991 because AFMC headquarters directed DMIF managers not to bill Air Force customers for some of the work that was completed. An AFMC official said that the Command directed DMIF managers to do this work without charge because (1) Air Force headquarters directed DMIF to reduce its sales prices and (2) this was the quickest and most efficient way to comply.

Senior DOD budget and policy analysts stated that AFMC headquarters' decision not to charge Air Force customers for work performed (1) caused financial reports to provide a misleading picture of DMIF's performance and (2) was inconsistent with a DOD initiative to develop industrial fund sales prices that approximate the costs incurred in providing goods and services to customers. This decision also had the same effect as a transfer of funds from DMIF to the Air Force Operation and Maintenance appropriation.

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### Profits Are Due to Improper or Questionable Practices

After several years of losses, DMIF made a \$26 million profit in fiscal year 1991 and a \$124 million profit for the first half of fiscal year 1992. In a budget document that was provided to the Congress, DOD attributed this turnaround to DMIF maintenance activities' more businesslike operations and to productivity improvement and cost reduction initiatives. However, GAO's analysis showed that DMIF's recent profits were due almost entirely to (1) improperly charging customers for work that was not performed and (2) the following questionable practices: (a) transfers of more than

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\$85 million from Air Force Operation and Maintenance appropriations to DMIF that were based on overestimated costs, (b) an AFMC policy that authorizes DMIF maintenance activities to increase prices over those previously approved by DOD, and (c) surcharges that were added to DMIF's fiscal year 1992 sales prices in order to recover some of the fund's prior year losses. These questionable or improper practices demonstrate that there is not always a businesslike relationship between DMIF and its customers. These practices also served to improperly extend the life of customers' expired appropriations and distorted the budget data that the Congress used to oversee DMIF operations.

In regard to the use of surcharges to eliminate prior year losses, DOD officials stated that this practice is in accordance with DOD policy. They believe that the prior year losses are costs to DMIF and that future prices charged customers should be increased to recover these costs. However, GAO's analysis showed that the use of these surcharges may (1) significantly distort DMIF's operating results for the current period and (2) generate additional cash that is not needed to finance the operations of the DMIF activities. If additional funds are needed, DMIF should be required to request these funds through the appropriation process. This approach would provide an incentive for DMIF to operate efficiently and give the Congress an opportunity to review DMIF's operations and determine if additional funds are needed.

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### Projected Savings Are Questionable

AFMC has developed a plan to reduce DMIF's fiscal year 1991-95 operating costs by \$1.1 billion as part of a DOD initiative to reduce depot maintenance costs, but it is unlikely to achieve these savings. One reason for this is that DMIF managers do not have accurate data on how much specific types of repairs should and do cost and thus cannot effectively identify and improve inefficient operations. Another reason is that the AFMC plan relies heavily on questionable assumptions about the savings that can be achieved by having the public and private sectors compete for work. For example, GAO's analysis showed that, while the savings DMIF will ultimately achieve as a result of its fiscal year 1991 work load competitions cannot be precisely quantified, they will be considerably less than the 20 percent that AFMC assumed in its plan. Similarly, the AFMC plan assumes that DMIF will save about \$190 million during fiscal years 1991-95 by applying lessons learned from its work load competitions to work loads that are not competed, but AFMC officials could not provide any examples of "lessons learned" savings when GAO contacted them in May 1992.

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## Recommendations

GAO is making recommendations to the Secretary of Defense, the Secretary of the Air Force, and the AFMC Commander to improve DMIF's billing, price-setting, and financial management practices. The recommendations focus on ensuring that (1) DMIF charges its customers for all authorized work that is accomplished, (2) DMIF's sales prices for depot maintenance services are based on realistic estimates of the costs that will be incurred in providing these services, (3) prices are not adjusted by factors not directly related to the costs incurred, such as surcharges added to recover prior year losses, (4) DMIF is not used to improperly extend the life of its customers' expired appropriations, and (5) existing policy guidance is properly implemented.



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# Contents

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<b>Executive Summary</b>		<b>2</b>
<b>Chapter 1</b>		<b>10</b>
<b>Introduction</b>		
	Why Industrial Funds Were Established	10
	How Industrial Funds Operate	10
	Air Force Depot Maintenance Operations	13
	Implementation of DOD's Initiative to Reduce Depot Maintenance Costs	13
	Implementation of the Defense Business Operations Fund	14
	Objectives, Scope, and Methodology	15
<b>Chapter 2</b>		<b>17</b>
<b>Losses Were Caused by Higher Than Expected Costs</b>		
	DMIF Was Directed Not to Bill Customers for Work Performed	17
	Sales Prices Are Based on Expected Costs	18
	Unrealistic Productivity Estimates Are a Continuing Problem	19
	Conclusions	23
	Recommendations	23
<b>Chapter 3</b>		<b>24</b>
<b>DMIF's Improved Financial Performance Is Misleading</b>		
	DMIF Improperly Retained Expired Customer Funds	24
	Fund Transfers Were Based on Overestimation of DMIF's Costs	28
	DMIF Is Not Complying With DOD's Rate Stabilization Policy	30
	Use of Surcharges to Recover Prior Year Losses Distorts DMIF's Operating Results	31
	Conclusions	31
	Recommendations	32
<b>Chapter 4</b>		<b>33</b>
<b>Customer Funding Requests Exceed DMIF's Ability to Do the Work</b>		
	Estimate of Excess Customer Funds Is Conservative	34
	Conclusions	35
	Recommendations	35

<b>Chapter 5</b>		36
<b>Projected Cost Reductions Are Questionable</b>	Competition Savings Can Not Be Substantiated	36
	DMIF Managers Need Better Data on Repair Costs	39
	Conclusions	41
<b>Appendixes</b>	Appendix I: DMIF Profits on Contracts Reviewed by GAO	44
	Appendix II: Major Contributors to This Report	47
<b>Tables</b>	Table 2.1: Net Income for DMIF's In-House Operations During Fiscal Years 1988 Through 1991	17
	Table 2.2: Comparison of DMIF Projected and Actual Output Per Paid Man-day for Fiscal Years 1988 Through 1992	20
	Table 2.3: ALCs' Actual and Predicted Output Per Paid Man-day for Fiscal Years 1988 Through 1993	22
	Table 3.1: Net Income for DMIF's Contract and In-House Operations During Fiscal Years 1988 Through 1991	25
	Table 4.1: DMIF's Year-end Backlogs of Work for Fiscal Years 1987 Through 1991	33
<b>Figure</b>	Figure 1.1: How Industrial Funds Operate	12

**Abbreviations**

AFB	Air Force Base
AFMC	Air Force Materiel Command
ALC	Air Logistics Center
DBOF	Defense Business Operations Fund
DMRD	Defense Management Report Decision
DMIF	Depot Maintenance Industrial Fund
DOD	Department of Defense
DPSH	direct product standard hour
GAO	General Accounting Office
OPMD	output per paid man-day
RIF	reduction in force

# Introduction

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Department of Defense (DOD) industrial funds are used to finance the operations of industrial and commercial type activities that provide common services within DOD. Depot maintenance (for ships, aircraft, combat vehicles, and other items) and transportation services (airlift, sealift, and traffic management) are examples of these common services. This report discusses the Air Force Depot Maintenance Industrial Fund (DMIF), which financed about \$3.6 billion of depot maintenance services during fiscal year 1991.

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## Why Industrial Funds Were Established

During the 1940s, the Hoover Commission, while studying abuses in government operations, found that the military budget and appropriation processes were highly inefficient. For example, the Commission found that managers at industrial activities did not know the cost of individual jobs and, therefore, concentrated on obtaining funds to support their existing programs rather than improving the efficiency of their operations. Similarly, the Commission found that, because industrial activities' customers were not charged for the work performed, they were seldom constrained by financial considerations.

To correct problems such as these, the Congress, in 1949, amended the National Security Act of 1947 to authorize the establishment of industrial funds.<sup>1</sup> In establishing the funds, the Congress intended to introduce the discipline and incentives of private industry and commerce to industrial activities and their customers.

Industrial funds were expected to improve government operations by establishing a buyer-seller relationship between fund activities and their customers. The fund activities would be financially dependent upon obtaining orders and matching costs with reimbursements. Consequently, they would be motivated to (1) improve cost estimates and controls and (2) identify and correct inefficiency and waste. Customers would be forced to pay for services rendered and would, therefore, be motivated to order only necessities and to pay only the minimum price.

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## How Industrial Funds Operate

Industrial funds receive their initial working capital through either a Congressional appropriation or a transfer of resources from existing appropriations or funds. They use these resources to finance the initial cost of providing the goods and services that are ordered by their customers. Thereafter, as the industrial funds do work and incur costs,

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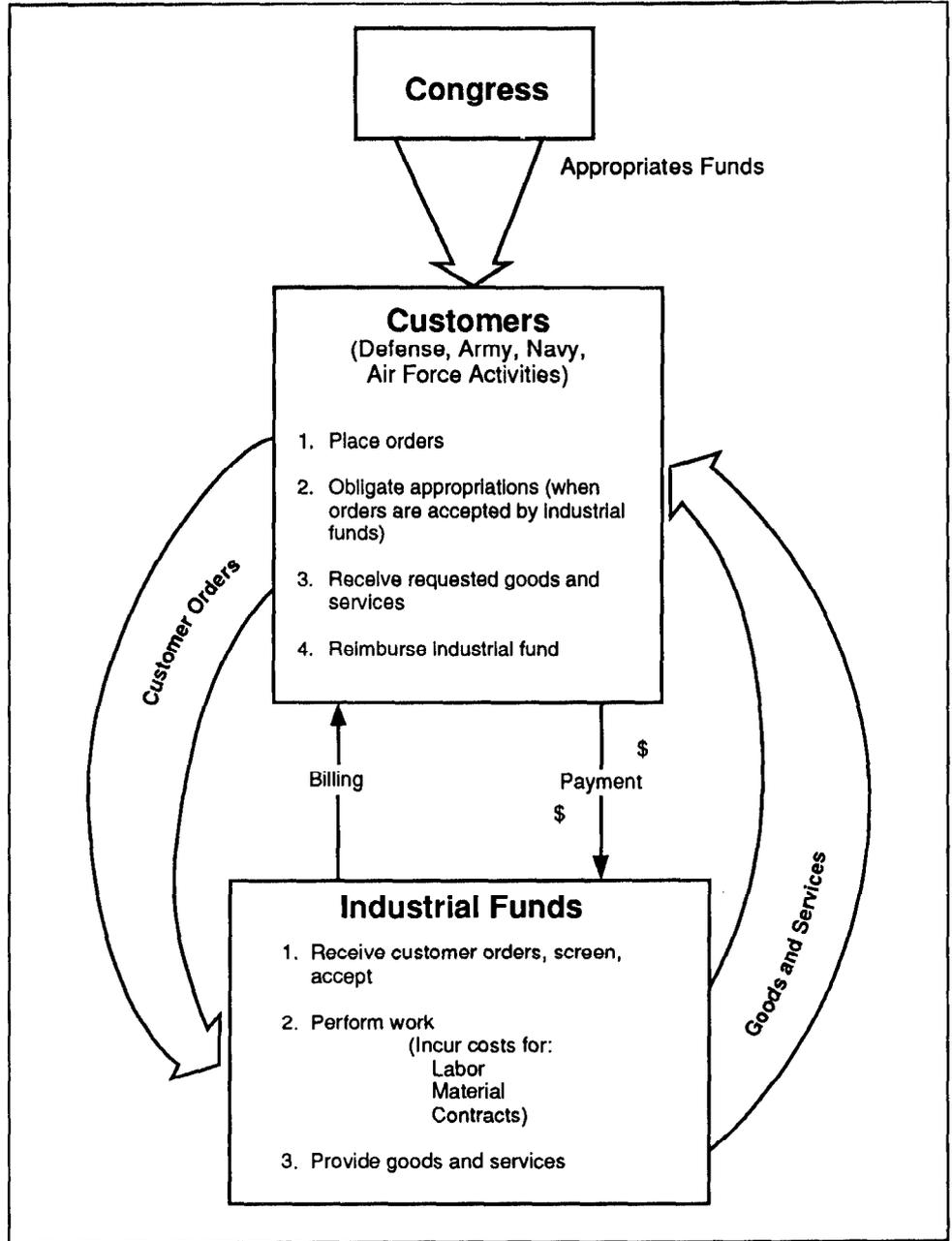
<sup>1</sup>This authorization is now found at 10 U.S.C. 2208.

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they bill customers on the basis of predetermined prices—commonly referred to as stabilized prices. Payments from customers are then used to finance subsequent operations, much as sales revenues are used in commercial enterprises. Once established, industrial funds are intended to be self-sustaining and to operate on a break-even basis over the long term.

Because industrial funds are complex and generally do not receive annual appropriations, the Congress has frequently expressed concern about its limited ability to subject industrial fund operations to close scrutiny. However, the Congress can directly affect industrial funds through the establishment or prohibition of specific policies or practices. For example, it can prohibit DOD from transferring excess cash from an industrial fund to its parent service's Operation and Maintenance appropriation or, conversely, from the Operation and Maintenance appropriation to the industrial fund. In addition, the Congress exercises indirect oversight through the authorization and appropriation processes, which permit it to adjust resource and program levels of industrial fund customers. The operation of industrial funds is illustrated in figure 1.1.

Figure 1.1: How Industrial Funds Operate



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## Air Force Depot Maintenance Operations

The Air Force Materiel Command<sup>2</sup> (AFMC) is responsible for providing depot maintenance services within the Air Force. This includes such services as the overhaul, repair, and alteration of aircraft, inventory components, missiles, and other equipment. Depot maintenance differs from maintenance performed at Air Force bases worldwide in that depot maintenance tasks are generally more complex, frequently require more extensive shop facilities and equipment, and typically involve personnel with more specialized skills.

The Depot Maintenance Industrial Fund (DMIF) finances both in-house and contract depot maintenance services. In-house services include those services performed by Air Force employees at five Air Logistics Centers (ALCS), the Aerospace Guidance and Metrology Center, the Aerospace Maintenance and Regeneration Center, and an overseas depot. Contract operations include depot maintenance performed (1) by commercial repair sources and (2) through interservice support agreements with other DOD components, primarily the Army and Navy. The Air Force generally provides depot maintenance services with its in-house resources unless (1) in-house maintenance activities lack the technical data, test equipment, or capacity to do the work or (2) the use of a contractor or interservice support agreement is more economical.

During the 4-year period ending September 1991, DMIF's in-house operations lost about \$459 million while its contract operations made a profit of \$209 million. During this same period, the amount of unfinished work DMIF carried forward from one fiscal year to the next increased by half a billion dollars.

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## Implementation of DOD's Initiative to Reduce Depot Maintenance Costs

Defense Management Report Decision (DMRD) 908, "Consolidating Depot Maintenance," directed the military services to save \$3.9 billion during fiscal years 1991-95 by reducing the cost of depot maintenance operations. The services are to save \$1.7 billion through internal streamlining and by reducing the size of their depot maintenance infrastructure, and \$2.2 billion through the development and implementation of a joint long-range plan. The long-range plan signed by the three service Under Secretaries in September 1990 states that the long-term savings will be achieved though

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<sup>2</sup>Air Force Materiel Command was activated on July 1, 1992, by combining the assets and responsibilities of the Air Force's former Logistics and Systems Commands. Prior to that, the Logistics Command was responsible for depot maintenance services. The abbreviation AFMC will be used in this report to refer to both the Logistics and Materiel Commands.

(1) increased competition for and interservicing<sup>3</sup> of depot maintenance work and (2) more effective use of in-house maintenance capacity. The baseline for measuring these savings is the fiscal year 1991-95 5-year defense plan associated with the fiscal year 1991 budget that was submitted to Congress in January 1990.

AFMC's First Annual Depot Maintenance Business Plan, dated April 26, 1991, outlined the Air Force's strategy for saving \$1.1 billion during fiscal years 1991-95. The plan indicates that the Air Force will save about \$391 million through such actions as (1) reducing overhead labor positions, (2) improving material management practices, and (3) discontinuing depot maintenance operations at an overseas depot.

The plan also indicates that most of the Air Force's \$719 million long-term savings goal will be achieved by implementing a comprehensive public/private competition program. Under this program, which is patterned after a program the Navy first initiated as a cost savings initiative in fiscal year 1985, DMIF's in-house maintenance activities will compete with the other services' depot maintenance activities and the private sector for work.

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## Implementation of the Defense Business Operations Fund

In October 1991, DOD implemented the Defense Business Operations Fund (DBOF), which consolidated the nine existing industrial and stock funds as well as the Defense Finance and Accounting Service, Defense Commissary Agency, Defense Industrial Plant Equipment Services, Defense Reutilization and Marketing Service, and Defense Technical Information Service. According to DOD, the primary goal of DBOF is to encourage support organizations such as maintenance facilities to provide quality goods and services at the lowest cost. This is to be accomplished, in part, by (1) identifying the full cost of providing goods and services to customers, (2) measuring performance on the basis of cost goals, and (3) providing better information on the operation of DBOF's various activities to decision makers in DOD and the Congress.

The Army, Navy, and Air Force industrial funds have maintained their individual identities as part of DBOF, and they have continued to operate under many of the same policies and procedures that were already in place. In addition, functional and cost management responsibilities for DBOF activities have remained with the Military Departments and Defense Agencies. However, cash management responsibilities for all DBOF

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<sup>3</sup>Interservicing refers to the practice of having one military service perform work for another.

activities have been consolidated under one Treasury code and have been transferred to DOD. In fiscal year 1993, DBOF activities are expected to have total revenues of about \$81 billion.

## Objectives, Scope, and Methodology

Based on a request from the Chairman, Subcommittee on Readiness, House Committee on Armed Services, and subsequent discussions with his office, the objectives of our review were to (1) identify the reasons for the operating losses that DMIF incurred during fiscal years 1988 through 1990, (2) evaluate the actions underway to eliminate DMIF's accumulated operating losses and to ensure that DMIF will operate on a break-even basis in the future, (3) determine if DMIF customers' fiscal year 1993 budget requests include funds for work that DMIF, because of its backlog of work, will not be able to accomplish during fiscal year 1993, and (4) determine if the Air Force has an effective plan for achieving the \$1.1 billion reduction in DMIF costs that was mandated by DMRD 908. We limited the scope of our review to the five ALCS since they accounted for 96 percent of DMIF's total revenue during fiscal year 1991.

To identify the reasons for DMIF's operating losses, we (1) analyzed financial reports for fiscal years 1988 through 1991 and for the first half of fiscal year 1992, (2) reviewed explanations of the losses that were contained in DMIF budget documents, (3) discussed the losses with managers and budget analysts at the five ALCS, AFMC headquarters, and Air Force headquarters, and (4) determined the basis for budget adjustments that AFMC headquarters, Air Force headquarters, and the Office of the Secretary of Defense made during their review of DMIF's budget requests for fiscal years 1990 and 1991.

To determine if appropriate action is being taken to eliminate depot maintenance activities' operating losses, we interviewed managers and budget analysts at the five ALCS and AFMC headquarters about actions that either have been or will be taken to reduce costs. In addition, we identified changes that have been made in DMIF's price-setting policies since 1987 and then discussed these changes with managers and budget analysts at five ALCS, AFMC, and Air Force headquarters, and with senior budget and policy analysts in the Office of the Secretary of Defense. We also obtained information on fund transfers made from the Air Force's Operation and Maintenance appropriation to DMIF, and analyzed a judgmental sample of 30 DMIF contracts that were closed out in fiscal year 1991. Contracts were included in the sample if (1) DMIF made a large profit or (2) the ratio of profit to cost was relatively high.

To determine if DMIF customers' fiscal year 1993 budget requests include funds for work that DMIF will not be able to accomplish during fiscal year 1993, we obtained (1) information on the backlog DMIF had on hand at the end of fiscal year 1991, (2) ALC managers' work load, staffing, and productivity projections for fiscal years 1992 and 1993, and (3) data on DMIF maintenance activities' actual productivity for the first 6 months of fiscal year 1992. We then used this information to estimate the backlog that would be on hand at the end of fiscal year 1993. Finally, we compared our backlog estimate with Air Force headquarters officials' estimates of how much carryover work is needed in order to ensure a smooth flow of work through in-house maintenance shops during the transition from one fiscal year to the next.

To determine if the Air Force has an effective plan for implementing DMRD 908, we (1) discussed the Air Force's plan with DMIF managers and AFMC headquarters officials and (2) reviewed supporting documentation for projected savings. In addition, in order to determine if DMIF financial systems produce the data that will be needed to effectively implement the Air Force's plan and to quantify the savings, we (1) identified data problems that have previously been reported by the DOD Inspector General, the Air Force Audit Agency, and us and (2) discussed these problems with DMIF managers. We also reviewed reports prepared pursuant to the Federal Managers' Financial Integrity Act of 1982 for fiscal years 1990 and 1991 to determine if the Air Force has reported any material weaknesses in its industrial fund accounting systems and, if so, the corrective action being taken.

We worked at the Office of the Secretary of Defense, Washington, D.C.; Air Force headquarters, Washington, D.C.; AFMC headquarters, Wright Paterson Air Force Base (AFB), Ohio; the Sacramento ALC, McClellan AFB, California; the Oklahoma City ALC, Tinker AFB, Oklahoma; and the Warner Robins ALC, Robins AFB, Georgia. We also obtained information from the Ogden ALC, Hill AFB, Utah and the San Antonio ALC, Kelly AFB, Texas.

As requested by the Chairman's office, we did not obtain written comments on a draft of this report. We did, however, discuss its contents with cognizant DOD and Air Force officials and have incorporated their views where appropriate. Our review was performed from June 1991 through September 1992 in accordance with generally accepted government auditing standards.

# Losses Were Caused by Higher Than Expected Costs

DMIF's in-house maintenance activities lost about \$459 million during fiscal years 1988 through 1991 and would have incurred additional losses had it not been for the questionable billing and pricing practices that they used to generate additional revenue during fiscal year 1991.<sup>1</sup> One cause of the losses was an AFMC headquarters decision not to bill Air Force customers for some of the work that was accomplished. However, the losses occurred primarily because the DMIF work force did not achieve productivity goals that DMIF managers incorporated into their budget estimates and sales prices.

Table 2.1 shows DMIF's annual income on in-house operations over this 4-year period.

**Table 2.1: Net Income (Loss) for DMIF's In-House Operations During Fiscal Years 1988 Through 1991**

Dollars in millions	
Fiscal year	Amount of gain (loss)
1988	(\$116)
1989	(\$166)
1990	(\$189)
1991	\$ 12
<b>Total</b>	<b>(\$459)</b>

## DMIF Was Directed Not to Bill Customers for Work Performed

DMIF lost about \$93.4 million because AFMC headquarters directed DMIF not to bill Air Force customers for \$42.7 million of work performed in-house in fiscal year 1990 and \$50.7 million of work contracted out in fiscal year 1991. An AFMC official stated that AFMC took this action because (1) Air Force headquarters directed DMIF to reduce its sales prices and (2) this was the quickest and most efficient way to comply.

Air Force headquarters officials stated that they were aware of AFMC's decision not to bill customers for work performed, and they indicated that it was improper for DMIF to accomplish the price reductions in this manner. However, these officials did not stop DMIF from implementing this guidance, and they did not notify DOD.

When we discussed this matter with senior DOD budget and policy analysts, they stated that DOD policy requires industrial fund activities to bill their customers for all work performed. They also said that AFMC's decision not to charge Air Force customers for work performed (1) caused financial reports to provide a misleading picture of DMIF's performance and (2) was

<sup>1</sup>See chapter 3 for a discussion of these questionable practices.

inconsistent with the businesslike approach DOD is trying to foster in its industrial funds. This decision also had the same effect as a transfer of funds from DMIF to the Air Force Operation and Maintenance appropriation.

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## Sales Prices Are Based on Expected Costs

DOD policy requires industrial funds to establish sales prices that allow them to recover their expected costs from their customers. It also requires the industrial funds to establish their sales prices prior to the start of each fiscal year, and to apply these predetermined or “stabilized” prices to all orders received during the year—regardless of when the work is actually accomplished or what costs are actually incurred. Because sales prices are based on expected rather than actual costs, higher-than-expected costs can cause industrial funds to incur losses and lower-than-expected costs can result in profits.

DOD established the rate stabilization policy in 1975 to protect customers from unforeseen inflationary increases and other cost uncertainties. The intent of the policy is to ensure that customers will not have to reduce their programs to pay for higher-than-expected prices. This policy also allows customers to provide more reliable work load estimates to industrial fund activities which, in turn, should allow the industrial fund activities to better plan for the efficient use of their resources.

The process DMIF uses to develop its stabilized prices begins as much as 3 years before the prices go into effect, with each ALC developing work load projections for the budget year. After an ALC estimates its work load, it (1) uses productivity projections to estimate how many people it will need in order to accomplish the work, (2) prepares a budget that identifies the labor, material, and other expected costs, and (3) develops sales prices that, when applied to the projected work load, will allow it to recover operating costs from its customers.

The ALCS’ budget estimates are reviewed and consolidated by AFMC headquarters, and the consolidated estimates are then reviewed by Air Force headquarters and the Office of the Secretary of Defense before submission to the Congress as part of the Defense Business Operations Fund Overview. Any changes made during the budget review process are incorporated into the ALCS’ sales prices before the start of the fiscal year.

Because DMIF sales prices are based on assumptions that are made as much as 3 years before the prices go into effect, some variance between

expected and actual costs is inevitable. DOD recognizes this and requires DMIF and other industrial funds to recoup losses from customers or return profits to them by adjusting subsequent years' sales prices. However, when sales prices yield revenues that are consistently lower than actual costs, as DMIF's did during fiscal years 1988 through 1991, it indicates that there may be systemic problems with either the operation of the fund or the methodology and assumptions used to estimate future costs.

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## **Unrealistic Productivity Estimates Are a Continuing Problem**

Because the DMIF work force consistently failed to meet the productivity goals that were incorporated into the DMIF budget estimates for fiscal years 1988 through 1991, it completed less work than projected. This, in turn, caused labor and overhead costs per item produced to be higher than projected, and resulted in an estimated loss of more than \$200 million. In addition, the lower-than-expected productivity led to an increase in the amount of unfinished work the ALCS had to carry forward from one fiscal year to the next.

The increased carryover caused further losses because DOD's rate stabilization policy requires DMIF to charge customers the prices in effect when the work is ordered, and prevents it from passing on cost increases that occur in subsequent years. For example, AFMC budget officials estimate that the requirement to charge fiscal year 1989 prices on the additional work that was carried over to fiscal year 1990 cost DMIF's in-house maintenance activities about \$50.1 million, or about 26 percent of their fiscal year 1990 loss.<sup>2</sup>

DMIF managers are acting to reduce costs and improve productivity. For example, they are trying to increase their work force's productivity by improving its ability to quickly and efficiently adjust to changing work loads. However, the trend of higher-than-expected costs and lower-than-expected productivity is likely to continue during fiscal years 1992 and 1993, primarily because DMIF managers do not believe they can achieve the improved productivity and lower cost projections that AFMC headquarters and the Office of the Secretary of Defense directed them to incorporate into their budget estimates for these years.

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<sup>2</sup>DMIF managers consider the impact of carryover work when they develop their sales prices. However, when the amount of carryover is higher than expected, as has been the case in recent years, DMIF will suffer a loss.

**Productivity Has Consistently Been Less Than Budget Projections**

To measure their work force's productivity, DMIF managers use a performance indicator called the Output per Paid Man-day (OPMD). This statistic measures the relationship between production, measured in "Direct Product Standard Hours" (DPSH),<sup>3</sup> and total labor time available (for both direct labor and overhead personnel). For example, a budgeted OPMD value of 4.0 means that DMIF managers expect the work force to complete 4.0 DPSHs of work for every 8 hours of payroll time.

As shown in table 2.2, the DMIF work force's actual productivity was less than its projected productivity for fiscal years 1988 through 1991 and the first half of fiscal year 1992.

**Table 2.2: Comparison of DMIF Projected and Actual Output Per Paid Man-day for Fiscal Years 1988 Through 1992**

	1988	1989	1990	1991	1992
Budget projection	4.05	3.94	3.95	3.97	4.17
Actual	3.84	3.87	3.70	3.91	3.82 <sup>a</sup>

<sup>a</sup>Actual data for the first 6 months of fiscal year 1992.

The work force's lower-than-expected productivity is also the primary reason the amount of unfinished work that in-house maintenance activities carried forward from one fiscal year to the next increased from \$455 million at the end of fiscal year 1987 to \$771 million at the end of fiscal year 1991. Our analysis showed that the in-house maintenance activities' backlog would have decreased to \$303 million by the end of fiscal year 1991 if they had achieved their projected productivity levels during this 4-year period.

**Productivity Has Been Adversely Affected by Unstable Work Loads**

DMIF managers cited the frequent changes that have occurred in the size and mix of DMIF's work load as one of the primary causes of their work force's lower-than-expected productivity. These managers noted that the DMIF work force consists primarily of full-time civil service employees, and they indicated that it is very difficult to rapidly release these employees when the work load declines. As a result, when the level of customer orders decreases significantly, as it did in fiscal year 1988, DMIF can be left with more employees than it needs to do the work. This adversely affects its productivity.

<sup>3</sup>A DPSH is the time during which a specified amount of work of acceptable quality is or can be produced by qualified workers following the prescribed methods, working at a normal pace, and experiencing normal fatigue and delays.

Changes in DMIF's work load mix have also caused productivity problems. For example, in fiscal year 1990, the overall size of DMIF's in-house work load remained about the same as the previous year's level, but a shift in the work load mix created a resource imbalance and a retraining requirement. Maintenance personnel who had previously been working on engines and exchangeable items<sup>4</sup> had to be retrained to work on airframes when the airframe work load increased by about 476,000 hours, and the work load on engines and exchangeable items decreased by about 566,000 hours.

DMIF managers can minimize the adverse impact of work load changes if they are given sufficient warning to plan for the changes. For example, if they are told a major work load reduction will occur in 2 years, they can restrict hiring to more smoothly reduce their capability during the intervening 2 years. However, if warning is not given, as was the case in fiscal year 1988 when the level of new customer orders was 19 percent less than projected, DMIF managers may not be able to react quickly enough and the work force's productivity may suffer.

In 1990, in an effort to better plan for future work load changes, AFMC headquarters analysts compared DMIF's existing capability with its projected work load for fiscal years 1991 through 1995. They determined that DMIF's work load would be declining faster than the work force could be reduced through normal attrition. As a result, during fiscal year 1991, DMIF maintenance activities released their temporary and on-call employees, allowed employees to retire early, and released 1,211 permanent employees.

DMIF managers informed us that these actions have better aligned the size of their work force with DMIF's projected work load through fiscal year 1995, but they also realize that the release of all temporary and on-call workers has reduced their work force's ability to quickly and efficiently react to work load changes in the future. Further, these managers stated that current plans to conduct work load competitions between DMIF's in-house maintenance activities and the private sector (see chapter 5) will make unanticipated work load changes even more common in the future. In their opinion, if they are expected to operate DMIF in an efficient and businesslike manner, then they should be allowed to develop personnel policies and practices that make it easier to hire and release employees in response to changing work loads.

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<sup>4</sup>Exchangeable items are components of aircraft and other items of equipment that, if damaged, can be repaired or overhauled for less than the cost of a new item.

**Productivity Goals Are Unrealistic**

The DMIF work force's lower-than-budgeted productivity is likely to continue during fiscal years 1992 and 1993 because DMIF officials used overly optimistic productivity assumptions when they developed the DMIF budgets for these years. When questioned about the large difference between the assumptions used to develop the fiscal year 1992 budget and their actual productivity for the first 6 months of the year (see table 2.2), ALC budget officials said the primary reason for not achieving the projected productivity level was that AFMC headquarters directed them to redo their initial budget estimates using higher productivity assumptions and lower estimates of the cost of maintenance work. Two reasons AFMC headquarters cited for these changes were the need to (1) achieve the savings required by DMRD 908 and (2) improve the ALCS' competitive standing in relation to contractors.

As shown in table 2.3, our analysis showed that, while 3 ALCS' actual productivity during the first half of fiscal year 1992 was better than their average productivity during fiscal years 1988-91, none achieved the improved productivity levels that AFMC headquarters directed them to use in their budget estimates.

**Table 2.3: ALCs' Actual and Predicted Output Per Paid Man-day for Fiscal Years 1988 Through 1993**

ALC	1988-91 Actual	1992 Predicted	1992* Actual	1993 Predicted
Oklahoma City	3.82	4.28	3.81	4.26
Ogden	3.79	4.13	3.88	4.04
San Antonio	3.82	4.18	3.58	3.95
Sacramento	3.84	4.14	3.91	4.33
Warner Robins	3.92	4.14	3.94	4.17

\*First 6 months of the fiscal year.

**Cost Reduction Goals Were Unrealistic**

DMIF sales prices are established to recover expected costs. Consequently, when headquarters budget officials reduce DMIF managers' cost projections, they also reduce DMIF's sales prices. Such lower sales prices, in turn, allow the budget officials to reduce the funding needs of DMIF customers without reducing the amount of work the customers can finance. However, without compensating cost cutting measures, reductions in cost estimates can cause DMIF to incur losses that, under DOD's current policy, must be recouped through increases to future years' sales prices.

Our analysis showed that the Office of the Secretary of Defense made questionable reductions in DMIF's cost projections during its review of DMIF's budget estimate for fiscal year 1993. For example, it cited the implementation of DBOF as the basis for a 1 percent reduction in DMIF's projected costs for fiscal year 1993, even though DOD officials acknowledge that DBOF's implementation is expected to have minimal impact on DMIF operations.

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## **Conclusions**

DMIF has not been able to meet its financial goal of operating on a break even basis. For fiscal years 1988 through 1991, DMIF's in-house maintenance activities lost about \$459 million, primarily because (1) DMIF did not always charge customers for work performed and (2) productivity levels were consistently lower than those used in budget projections. Productivity is also likely to be less than the levels projected for fiscal years 1992 and 1993, and costs are likely to be higher than budgeted because (1) AFMC headquarters directed DMIF officials to use overly optimistic productivity assumptions in their budget estimates and (2) the Office of the Secretary of Defense made questionable reductions to DMIF's cost estimates during its reviews of DMIF budget submissions.

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## **Recommendations**

We recommend that the Secretary of the Air Force direct the AFMC Commander to (1) comply with the DOD policy that requires industrial fund activities to bill their customers for all authorized work that is performed, (2) use more realistic productivity assumptions in future DMIF budget submissions as a basis for preparing the President's budget, and (3) identify the changes to existing personnel practices and regulations that are needed in order to allow DMIF to better respond to unanticipated work load changes and to operate the fund in a more businesslike manner.

# DMIF's Improved Financial Performance Is Misleading

After several years of losses, including a \$151 million loss in fiscal year 1990, DMIF reported a \$26 million profit in fiscal year 1991 and a \$124 million profit for the first half of fiscal year 1992. While DOD attributed this turnaround to DMIF's more businesslike operations, productivity improvements, and cost reductions, our analysis showed that DMIF's recent profits were due almost entirely to improper or questionable practices that allowed DMIF to increase the amount of revenue it received from its customers without increasing the amount of work it accomplished. These practices (1) demonstrate that DMIF did not always have a businesslike relationship with its customers, (2) caused financial reports and budget documents to provide a misleading picture of DMIF's performance, and (3) made it difficult for DOD and the Congress to exercise their oversight responsibilities over DMIF and the budget requests of DMIF customers.

## DMIF Improperly Retained Expired Customer Funds

DMIF customers' funds are usually provided through congressional appropriations that are available for a specified period. Most are 1-year Operation and Maintenance appropriations. Once the specified period is over, the appropriations expire, and the funds may no longer be obligated to satisfy new requirements. However, obligated funds can be used to pay for the completion of work that was ordered before the appropriations expired.

A policy AFMC implemented in fiscal year 1988 for DMIF contract operations, and in fiscal year 1991 for in-house operations, has allowed DMIF to improperly "earn" more than \$200 million in revenue by retaining obligated funds from expired customer appropriations that were no longer needed to finance repairs. Reductions in the scope of work, such as reductions in quantities of items to be repaired, and reductions in contract prices from previous estimates were the primary reasons the obligated funds were no longer needed.

Under AFMC's policy, whether DMIF returns or retains customer funds that are no longer needed to finance repairs depends on the status of the customer's appropriation. If the appropriation has not expired, the funds are returned to the customer so they can be used to satisfy additional requirements. However, if the appropriation has expired, and thus the funds may no longer be obligated to satisfy new requirements, DMIF retains them.

**Policy Change Led to Large Profits on Contract Operations**

In March 1988, AFMC changed the pricing policy for DMIF contract operations in order to prevent a possible violation of the Anti-Deficiency Act. In a letter entitled "Actions Required to Improve Budgetary Resources," it advised the ALCS that, effective immediately, they were no longer to adjust sales prices on any contracts that were financed with funds from expired customer appropriations. The ALCS interpreted this guidance to mean that DMIF was to retain expired customer funds that were no longer needed to finance repairs.

This policy change has served to extend the life of appropriations that have expired. For example, since the unneeded funds DMIF retained from contracts that were closed during fiscal year 1991 were from appropriations that had expired as much as 7 years earlier, they could not have been obligated for new requirements if they had been returned to customers; however, by allowing DMIF to retain the funds, the Air Force was able to use them to finance a portion of DMIF's fiscal year 1991 operations.

In addition, the ALCS' implementation of this policy change is the primary reason DMIF was able to report a profit of about \$209 million on its contract operations during fiscal years 1988 through 1991. As shown in table 3.1, this profit has allowed DMIF to partially offset large losses of its in-house operations.

**Table 3.1: Net Income (Loss) for DMIF's Contract and In-House Operations During Fiscal Years 1988 Through 1991**

Dollars in millions					
	1988	1989	1990	1991	Total
In-house	(\$116)	(\$166)	(\$189)	\$12	(\$459)
Contract	105	52	38	14 <sup>a</sup>	209
<b>Total</b>	<b>(\$ 11)</b>	<b>(\$115)<sup>b</sup></b>	<b>(\$151)</b>	<b>\$26</b>	<b>(\$250)<sup>b</sup></b>

<sup>a</sup>As discussed in chapter 2, DMIF did not bill Air Force customers for \$51 million of contract work that was accomplished in fiscal year 1991. If it had, its profit on its fiscal year 1991 contract operations would have been \$65 million.

<sup>b</sup>Does not total due to rounding.

To identify the reasons for the large profits that DMIF's contract operations have earned in recent years, we reviewed a judgmental sample of 30 DMIF contracts that were closed during fiscal year 1991. As shown in appendix 1, DMIF's profit on these contracts ranged from \$3,200 to \$641,800. As is also shown in appendix I, DMIF made a profit of more than 100 percent on about half of the contracts in our sample, and more than 1,000 percent on

three of them. In three instances, we were unable to determine the reason for the profit because supporting documentation was not available.

As the following examples illustrate, the reason for the DMIF profits on the 27 contracts we could analyze was either a reduction in scope or a reduction in contract price estimates.

- On December 21, 1989, an ALC awarded a \$22,200 contract to repair two search antennae. However, the contract was subsequently terminated when the customer found 10 serviceable antennae it had not been aware of and concluded that it was, therefore, no longer necessary to repair the damaged antennae. The contractor was ultimately paid \$994 to cover the costs it had incurred. Because the customer's funds had already expired when the contract was terminated, DMIF retained the remaining \$21,206.
- On May 6, 1985, an ALC awarded a contract at a not-to-exceed price of \$575,000 to repair 50 turbines used on F-15 aircraft. The contract amount was subsequently reduced about \$204,800 because of (1) a reduction in the contractor's unit repair price and (2) a reduction in the repair quantity from 50 to 45. However, because these reductions occurred after the customer's funds had expired, DMIF retained the \$204,800.
- On March 2, 1987, an ALC awarded a \$554,500 contract to inspect and repair 400 gyros used on the F-15 aircraft. The contract established fixed unit prices for four possible actions, ranging from a low of \$417 for units inspected and determined to be beyond economic repair to a high of \$1,337 for items requiring the most extensive type of repair. The contract amount was based on the assumption that all items would require the most costly type of repair; however, most required a less costly action, and thus the contract amount was ultimately reduced by \$288,600. Since the customer's funds had already expired when the contract amount was reduced, DMIF retained the \$288,600.

### **Improper Practices Have Been Extended to In-House Operations**

In September 1991, AFMC advised the ALCS that, with the exception of foreign military sales, all excess prior year customer funds financing orders placed with DMIF should be recognized as DMIF revenue rather than returned to the customers. This policy applied to both contract and in-house DMIF operations. Thus, the effect of this new policy guidance was to expand AFMC's March 1988 guidance for contract operations to include in-house operations.

As the following example illustrates, the ALCS have subsequently used this guidance to generate millions of dollars in revenue for work they did not

perform. In May 1991, a customer directed DMIF to stop work on eight aircraft scheduled to be phased out of the Air Force inventory within 2 years. DMIF was paid for all of the work it performed. In addition, in accordance with the September 1991 AFMC guidance, DMIF also retained about \$1.7 million remaining on a fiscal year 1990 customer order because the customer's funds had expired. However, \$2.9 million remaining on a fiscal year 1991 order had not yet expired and DMIF, therefore, returned the funds to the customer so they could be used to satisfy other requirements.

### Some Corrective Action Taken

In November 1991, we told an AFMC official that we believe DMIF should not retain expired customer funds that become available to DMIF as a result of a reduction in either the scope of the repair requirement or a contract price estimate. Subsequently, in a January 1992 letter to the ALCS, AFMC headquarters stated that expired funds must be returned to customers if there is a reduction in the quantity repaired.

While AFMC's January 1992 policy guidance was a step in the right direction, most DMIF managers were either not aware of it or had not implemented it when we contacted them in August and September of 1992. Consequently, we believe AFMC headquarters should develop controls to ensure that this guidance is properly implemented.

Further, AFMC's policy guidance still allows DMIF to retain expired customer funds that become available to DMIF as a result of reductions in contract price estimates. According to an AFMC official, the rationale for this policy is that any profit DMIF makes on an individual contract will either be used to offset losses incurred on other contracts or will be returned to customers through reductions to future sales prices.

In our view, the need to offset potential losses on other contracts is not a valid reason for allowing DMIF to retain the customers' funds. DMIF's role on contract operations is generally limited to issuing and administering the contracts. To cover the costs it incurs in fulfilling this role, DMIF generally adds a surcharge of about 2 percent to the contract amount. Consequently, if DMIF incurs losses on contract operations, it is probably an indication of a problem that warrants management attention. In our view, the way to increase the likelihood of this management attention is not to allow DMIF managers to use unearned revenue to offset their losses but rather to require DMIF managers to report and explain the losses.

Furthermore, although expired appropriation accounts are not available for new obligations, they may be used to absorb unexpected increases to existing obligations for 5 years after they expire (31 U.S.C. 1551-1558). Also, there is no legal basis for AFMC to treat unneeded funds from expired appropriations differently than unneeded funds from appropriations that are still available for new obligations. Accordingly, if the purpose for which the funds were provided no longer exists, DMIF should return funds to customers' appropriations, regardless of whether those appropriations have expired.

In our opinion, the return of unneeded funds to expired customer appropriations also makes sense from a financial management perspective. AFMC Regulation 66-8 states that the timely establishment of accurate repair requirements and prices is critical to ensuring that DMIF customers maximize the use of their funds while their appropriations are still available for obligation. However, there is currently no incentive for DMIF to accomplish this task promptly. In fact, there is a disincentive because DMIF will earn revenue if it does not finalize the contract amount until after the customers' funds have expired. By requiring DMIF to return unneeded funds to expired appropriations, this disincentive will be eliminated. In addition, we believe that requiring DMIF maintenance activities to provide information on funds that are returned to expired appropriations would allow AFMC headquarters to (1) identify the DMIF maintenance activities that are not finalizing repair requirements and prices promptly and (2) take appropriate action.

## **Fund Transfers Were Based on Overestimation of DMIF's Costs**

Despite the retention of \$65 million of unearned revenue from its contract operations, as just discussed, DMIF still would have suffered a loss during fiscal year 1991 if DOD had not allowed Air Force headquarters to transfer \$46 million from its Operation and Maintenance appropriation to DMIF during the last month of the fiscal year. The Air Force also transferred \$39 million to DMIF in fiscal year 1992. According to DOD and Air Force officials, the \$85 million in additional funds was needed because DMIF's stabilized prices did not fully reimburse it for the costs it incurred in performing Desert Storm and Desert Shield work.<sup>1</sup> For example, they said that revenue from stabilized prices did not reimburse DMIF for \$65 million in costs associated with productivity losses that occurred when workers shifted from one work load to another and for \$20 million for other reasons.

<sup>1</sup>Under 10 U.S.C. 2208, DMIF may be reimbursed for its costs from available appropriations.

Our analysis of the justification for these reimbursements of \$85 million showed that the Air Force overestimated the costs DMIF incurred in support of Desert Storm and Desert Shield. For example, it counted some costs twice when Air Force headquarters used a macro analysis of the ALCs' productivity to justify a \$65 million reimbursement while, at the same time, individual ALCs were citing productivity problems to justify either price increases or fund transfers at their level.<sup>2</sup>

In addition to this double counting, our analysis showed that the methodology Air Force headquarters used to estimate DMIF's unreimbursed costs caused overestimates. For example, we believe that Air Force headquarters considerably overestimated the impact Desert Storm and Desert Shield had on the DMIF work force's productivity. To estimate this impact, a headquarters analyst (1) compared DMIF's budgeted and actual productivity for fiscal year 1991, (2) determined that DMIF would have earned \$65 million in additional revenue if it had achieved its budgeted productivity, and (3) concluded that this \$65 million in lost revenue was an unreimbursed cost of Desert Storm and Desert Shield.

In our opinion, this methodology considerably overstates the impact Desert Storm and Desert Shield had on the DMIF work force's productivity because (1) DMIF's actual productivity has been lower than its budgeted productivity for every year since at least fiscal year 1988, (2) the difference between budgeted and actual productivity was considerably less in fiscal year 1991 than it was during both fiscal year 1990 and the first half of fiscal year 1992, and (3) DMIF managers told us that they believe that the confusion caused by a major reorganization and a conversion to a new type of computer, not Desert Storm and Desert Shield, were the primary causes of reduced productivity during fiscal year 1991.

In fact, several DMIF managers told us that Desert Storm and Desert Shield helped rather than hurt DMIF's financial performance. For example, one manager noted that most of DMIF's Desert Storm and Desert Shield work was in a work load category (exchangeable items) that showed a \$104 million profit during fiscal year 1991. Another pointed out that (1) DMIF was able to complete more work than it otherwise would have as a result of the additional overtime that was authorized for Desert Storm and Desert Shield work and (2) this additional work, in turn, allowed DMIF to achieve economies of scale by spreading its fixed costs over a larger work load.

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<sup>2</sup>All five ALCs either transferred funds or increased their sales prices in order to recoup unreimbursed Desert Storm and Desert Shield costs, but only one kept track of the total amount of the transfers and price adjustments. This ALC transferred \$5 million.

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## **DMIF Is Not Complying With DOD's Rate Stabilization Policy**

In July 1990, AFMC headquarters told DMIF activities that their sales prices should no longer be based on when they accept customer orders but rather on when they expect to accomplish the work.<sup>3</sup> This new policy has allowed DMIF activities to generate millions of dollars in additional revenue.<sup>4</sup> However, it is inconsistent with DOD's rate stabilization policy which, as noted previously, was established in fiscal year 1975, in part, to protect industrial fund customers from unanticipated price increases.

When questioned about their decision to deviate from DOD's longstanding rate stabilization policy, an AFMC official said the policy was adopted because (1) customers frequently place unanticipated orders late in the fiscal year so they can obligate all of their funds before they expire and (2) DMIF usually has to accomplish this additional work load in the next fiscal year when, because of inflation, costs are higher.

This official noted that, by charging the next year's prices, DMIF will be charging prices that more accurately reflect its costs. He acknowledged that there is no regulation that specifically authorizes AFMC's new policy, but said that he nevertheless considered it appropriate for an industrial fund to increase its prices if a customer's actions cause the fund's costs to increase, as is the case when DMIF receives unanticipated orders late in the fiscal year.

When we discussed AFMC's pricing policy with senior budget and policy analysts in the Office of the Secretary of Defense, they stated that they were not aware of it, and said they would not have approved it had the Air Force asked to implement it. They acknowledged that exceptions to the rate stabilization policy may be warranted in certain instances; however, they also stated that these instances are rare and indicated that all exceptions must be approved by the Office of the Secretary of Defense.

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<sup>3</sup>This policy was subsequently modified to include only unplanned orders that are accepted in the last 45 days of the fiscal year.

<sup>4</sup>All five ALCs implemented this policy at the end of fiscal year 1991, but only one kept track of the total amount of its price increases. This ALC increased its prices by \$2.5 million.

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## Use of Surcharges to Recover Prior Year Losses Distorts DMIF's Operating Results

DMIF maintenance activities are expected to generate several hundred million dollars of revenue as a result of surcharges that have been added to their sales prices for fiscal years 1992 and 1993. The use of these surcharges is in accordance with DOD policy guidance issued on August 13, 1991, that requires industrial fund activities to eliminate all of their accumulated prior year losses by the end of fiscal year 1993. DOD officials believe that the prior year losses are costs to DMIF and that future prices charged customers should be increased to recover these costs. However, the use of these surcharges may (1) significantly distort DMIF's operating results and (2) generate additional cash that is not needed to finance the operations of DMIF activities. For example, because DMIF's fiscal year 1992 sales prices include a surcharge of about 12 percent, DMIF managers may earn substantial profits, even if they do not achieve their productivity improvement and cost reduction goals.

In our April 1992 testimony<sup>5</sup> before the Subcommittee on Readiness, House Committee on Armed Services, we cited another reason for not using surcharges to eliminate industrial funds' accumulated prior year operating losses. One of the basic tenets of DBOF is that prices should reflect the actual costs incurred in providing goods and services to Fund customers—so customers can make cost-effective decisions such as whether to repair broken items or buy new ones. Consequently, in our April testimony, we stated that prices should, therefore, not be adjusted by factors such as surcharges that are not directly related to the costs incurred for the current period. In discussing this matter with DOD officials, they reiterated their position that imposing surcharges was an acceptable practice for recovering prior year losses.

In our opinion, if additional cash is needed, DBOF should be required to request additional funds through the appropriation process. In addition to eliminating the problems cited above, this approach would (1) provide an incentive for DBOF to operate efficiently and (2) give the Congress an opportunity to review the DBOF's operations and determine if additional funds are actually needed. In essence, the need to request funds would inform the Congress of how efficiently the DBOF is being managed.

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## Conclusions

The profits DMIF reported in fiscal year 1991 and the first half of fiscal year 1992 were the result of (1) improper billing or pricing practices such as charging customers for work not performed and (2) fund transfers from

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<sup>5</sup>Financial Management: Defense Business Operations Fund Implementation Status (GAO/T-AFMD-92-8, April 30, 1992).

Air Force Operation and Maintenance appropriations based on overestimated costs. These practices and fund transfers (1) demonstrate that there is not always a businesslike relationship between DMIF and its customers, (2) have served to improperly extend the life of funds in DMIF customers' expired appropriations, and (3) have distorted the financial data that the Congress uses in exercising its oversight responsibilities over DMIF operations and the appropriation requests of DMIF customers.

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## **Recommendations**

We recommend that the AFMC Commander direct DMIF maintenance activities to (1) return all customer funds that become available as a result of reductions in the scope of the repair requirement, (2) adjust prices charged customers to match corresponding adjustments made in finalizing contract price estimates, and (3) comply with the rate stabilization policy. We also recommend that the Commander (1) establish control procedures to ensure that this guidance is properly implemented and (2) monitor the amount of unneeded customer funds that are returned to expired appropriations.

We recommend that the Secretary of Defense (1) direct the Comptroller of Defense to ensure that DMIF does not charge its customers more than the approved stabilized prices, (2) direct DBOF activities to discontinue the practice of using surcharges to recoup prior year operating losses, and (3) request congressional appropriations whenever DBOF activities' accumulated prior year losses are adversely affecting the operation of the Fund.

# Customer Funding Requests Exceed DMIF's Ability to Do the Work

The DMIF work force's lower-than-projected productivity was the primary reason why the amount of unfinished work DMIF carried over from one fiscal year to the next grew from \$843 million at the end of fiscal year 1987 to \$1,348 million at the end of fiscal year 1991. This growing backlog<sup>1</sup> of work, in turn, is the reason DMIF customers' fiscal year 1993 budget requests include more than \$365 million for work that DMIF's in-house maintenance activities will be unable to start before fiscal year 1994.

When expressed in terms of equivalent months of revenue, the growth during this 4-year period has been from 2.6 months to 4.5 months, a 73-percent increase. Table 4.1 shows that, except in fiscal year 1988 when the level of new customers' orders for in-house work turned out to be 19 percent less than expected, the backlog of work has increased steadily.

**Table 4.1: DMIF's Year-end Backlogs of Work for Fiscal Years 1987 Through 1991**

Dollars in millions					
	1987	1988	1989	1990	1991
In-house	\$ 455	\$ 429	\$ 489	\$ 552	\$ 771
Contract	388	371	407	458	577
<b>Total</b>	<b>\$ 843</b>	<b>\$ 800</b>	<b>\$ 896</b>	<b>\$1,010</b>	<b>\$1,348</b>

Air Force officials and congressional committees have stated that industrial funds need some "carryover" work in order to ensure a continuous flow of work during the transition from one fiscal year to the next. However, congressional committees have also stated that the funding provided to industrial fund customers should be consistent with the industrial funds' ability to do the work. For example, in its December 1982 report (H. Rept. 943, 97th Cong.) on DOD's 1983 appropriation, the House Committee on Appropriations noted that there was little point in providing resources to industrial fund customers in fiscal year 1983 if there was dim hope of accomplishing the work in fiscal year 1983.

The Committee's report noted that, although industrial funds' total carryover backlog was hundreds of millions of dollars beyond the level needed, the Committee was recommending an initial reduction in industrial fund customers' fiscal year 1983 budget requests of only \$159.9 million. However, the Committee's report also directed DOD to ensure that industrial fund customers' fiscal year 1984 budget requests did not include funding for work unless (1) there was reasonable expectation that the work could be accomplished in fiscal year 1984 or (2) the work was

<sup>1</sup>The backlog equals the estimated cost to complete on-going work plus the price of funded work that has not been started.

needed in order to ensure a steady flow of work through the industrial activities.

Using the same premise, we determined that DMIF customers' fiscal year 1993 budget requests could have been reduced by at least \$365 million. This estimate is based on the facts that (1) DMIF's in-house maintenance activities had about 3.8 months of carryover, valued at \$771 million, at the end of fiscal year 1991, (2) our analysis showed that in-house maintenance activities' backlog of work will probably continue to grow during both fiscal years 1992 and 1993, and (3) Air Force headquarters officials stated that only 2 months of carryover is needed.

## Estimate of Excess Customer Funds Is Conservative

There are several reasons why our approach provides a conservative estimate for how much DMIF customers' fiscal year 1993 budget requests can be reduced. First, in computing the excess, we assumed that the \$771 million backlog the ALCs had on hand at the end of fiscal year 1991 would not grow during fiscal years 1992 and 1993, even though DMIF officials' optimistic budget projections indicate that the ALCs' backlog will grow by about \$63 million during this 2-year period.<sup>2</sup>

Secondly, our estimate does not consider DMIF's \$577 million backlog of contract work. When expressed in terms of equivalent months of revenue, the backlog of contract work on hand at the end of fiscal year 1991 represented over 6 months of work. Because we were told that the Air Force does not have any criteria for what constitutes an acceptable backlog level for contract work, we did not consider this backlog in our estimate of excess customer funds.

Finally, our estimate is conservative because it does not consider the uneven distribution of the maintenance backlog. While DMIF's in-house maintenance activities had an average of 3.8 months of backlog at the end of fiscal year 1991, the backlog projections for specific types of work at individual ALCs varied substantially. For example, one ALC estimated that it would achieve the Air Force's 2-month backlog criteria by the end of fiscal year 1992, and that it would have less than 2 months of backlog in three of its six major workload categories. Conversely, one ALC had an overall backlog of about 6.0 months as of September 1991, and in two work load categories—software and local manufacturing—it had more than a year of backlog.

<sup>2</sup>If DMIF officials had based their budget estimates on the productivity levels that the ALCs actually achieved during the first half of fiscal year 1992 rather than the optimistic estimates shown in table 2.3, they would have projected a \$466 million increase in the backlog.

Officials at this ALC expect their overall backlog to grow to about 7.0 months by the end of fiscal year 1992 and estimate that their software and local manufacturing backlogs will grow to about 16.1 months and 23.7 months, respectively. Thus, in fiscal year 1993, this ALC will theoretically have enough work to keep its work force busy in the software and local manufacturing areas, even if it does not receive any of the \$69 million in new software and local manufacturing orders that are expected.

We discussed this matter with the congressional defense committees. Based on our work, the Air Force's Operation and Maintenance Appropriation for fiscal year 1993 was reduced by about \$100 million for excess carryover.

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## Conclusions

There is little point in providing financial resources to industrial fund customers unless (1) there is a reasonable expectation that the work can be completed prior to the end of the fiscal year or (2) the work is needed in order to ensure a smooth flow of work through industrial fund activities at the end of the year.

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## Recommendations

We recommend that the Secretary of Defense direct the DOD Comptroller to limit industrial fund customers' fiscal year 1994 budget requests to work that (1) is likely to be accomplished during fiscal year 1994 or (2) is needed in order to ensure a continuous flow of work through industrial fund activities at the end of the year.

We also recommend that the Secretary of Defense direct the Secretary of the Air Force to (1) determine why DMIF has more than a 6-month backlog of contract work and (2) reduce the size of this backlog.

# Projected Cost Reductions Are Questionable

AFMC's First Annual Depot Maintenance Business Plan, dated April 26, 1991, provided a strategy to reduce DMIF's fiscal years 1991-95 cost by \$719 million through (1) increased competition for and interservicing of depot maintenance work and (2) more effective use of in-house maintenance capacity. However, we could not substantiate the savings AFMC reported for fiscal year 1991, and we question DMIF managers' ability to achieve future cost reduction goals, in part, because actual events have not supported the plan's assumptions that work load competitions can reduce costs by 20 percent. Further, managers do not have accurate data on how much specific types of repairs should or do cost and, therefore, cannot effectively identify and improve inefficient repair operations or reliably determine actual savings.

## Competition Savings Can Not Be Substantiated

AFMC plans to achieve about \$614 million,<sup>1</sup> or 85 percent, of DMIF's \$719 million long-term savings goal through increased competition. However, we could not substantiate the \$14 million competition savings the Air Force reported for fiscal year 1991 and question the reasonableness of the \$600 million competition savings it is projecting for fiscal years 1992 through 1995.

## AFMC's Competition Strategy

AFMC's strategy for achieving savings through work load competitions has three major components. First, according to AFMC officials, when AFMC conducted a Reduction in Force (RIF) in fiscal year 1991, funded personnel positions were eliminated to (1) better align the size of DMIF's work force with the fund's projected work load and (2) reduce overhead positions and, thereby, make the ALCs more competitive. These officials stated that, of the nearly 6,700 funded positions eliminated during fiscal year 1991, 1,101 were eliminated in order to reduce overhead. The \$190 million that AFMC officials expect to save during fiscal years 1991-95 by eliminating the 1,101 overhead positions was, therefore, considered a "competition" savings.

The second component of AFMC's competition strategy—the competitions that will be conducted—is expected to save a total of about \$234 million through 1995. According to an ALC contracting officer, these competitions use the same policies that have been used in the past for competitions among private firms and include four basic steps: (1) developing a

<sup>1</sup>The AFMC business plan indicates that the Air Force planned to save \$642 million of its \$719 million savings goal through competition. However, updated savings projections provided by the AFMC Business Office in September 1992 showed that the competition savings estimate had been reduced to \$614 million.

statement of work, (2) issuing a request for proposals, (3) receiving and evaluating the proposals, and (4) awarding the contracts. In addition, since the military services use different methods to estimate their costs, DOD has developed the Cost Comparability Handbook that identifies these differences and specifies how each service's proposals should be adjusted in order to make the cost estimates consistent.

AFMC conducted five public/private sector competitions during fiscal year 1991, with two multiyear contracts valued at about \$1.3 million per year awarded to ALCS and three multiyear contracts valued at about \$5.3 million per year awarded to private companies. Altogether, the \$6.6 million average annual value of these five contracts represents about 0.2 percent of DMIF's expected sales revenues for fiscal year 1992.

As of September 1992, AFMC was tentatively planning to conduct 51 additional public/private sector competitions during fiscal years 1992 through 1995. If all of these competitions are held, the 51 contracts that are awarded will have an estimated annual value of \$513 million, or about 13 percent of DMIF's expected sales revenue for fiscal year 1995.

AFMC's business plan states that, based on the Navy's experience, the competitions would result in cost savings of about 20 percent of the budgeted amount. As of May 1992, AFMC estimated that its overall savings would be about 18 percent for the five competitions it held during fiscal year 1991.

The final component of AFMC's competition strategy is the \$190 million that the Command expects to save by applying lessons learned from its work load competitions to similar work that is not competed. For example, if an ALC's estimate for the number of hours required to complete a work load that is subject to competition is considerably less than the estimate the ALC used prior to the competition, then there is an indication the ALC may be able to reduce its estimates for similar work that is not subject to competition. In order to maximize these "lessons learned" savings, AFMC headquarters has directed the ALCS to hold at least one competition for each of their major work load categories and to then apply lessons learned from these competitions to work that is not subject to competition.

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### **Savings Projections Are Questionable**

AFMC's savings projections are questionable for all three components of its competition strategy. For example, as noted previously, AFMC plans to save about \$190 million by applying lessons learned from its public/private

sector competitions to similar work that is not subject to competition; however, AFMC officials could not provide any examples of "lessons learned" savings when we contacted them in May 1992.

Similarly, AFMC officials reported that DMIF achieved a \$14.1 million "competition" savings during fiscal year 1991 as a result of the RIF that was conducted, but DMIF's productivity data does not substantiate these savings. As noted previously, AFMC's rationale for calling this a competition savings was its assertion that the RIF made the ALCS more competitive by eliminating unneeded overhead positions. If this were, in fact, the case, then the ALCS' productivity should have gone up after the RIF. However, as discussed in chapter 2, our analysis showed that (1) the DMIF work force's actual productivity for fiscal year 1991 was less than its budgeted productivity (the baseline for computing savings) and (2) the work force's productivity for the first half of fiscal year 1992 declined from the 1991 level.

Finally, AFMC's assumption that competition can reduce costs by an average of 20 percent is not supported by actual events. For example, AFMC estimated that one ALC's competition (1) cost about \$659,000 to conduct, (2) resulted in a \$29,000 reduction in the average unit repair cost, and (3) would ultimately save about \$498,000 (based on an expected repair quantity of 40 over a 5-year period). However, ALC managers told us that, because of force structure reductions and the ongoing replacement of the item, the expected repair quantity has been reduced from 40 to 3. Thus, instead of a net savings, this competition is now expected to result in a net cost increase of about \$578,000.

In another instance, AFMC headquarters estimated that an ALC's fiscal year 1991 competition would result in a savings of about \$3.6 million, or more than half of the total savings AFMC was expected to achieve from its fiscal year 1991 competitions. However, when we were briefed on the status of this competition in September 1992, an ALC official told us that the AFMC savings estimate failed to consider that there are many fixed costs that would not be eliminated when the work was shifted from the ALC to a contractor. The ALC official stated that the savings projection had been reduced to less than \$500,000.

AFMC officials acknowledged that the savings projections may be overly optimistic, but they nevertheless believe the competitions are beneficial. In their opinion, the most significant benefit is that the competitions are finally forcing the ALCS to take corrective action on their longstanding

problem of inaccurate cost estimates. This matter is further discussed in the following section.

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## DMIF Managers Need Better Data on Repair Costs

Because they do not have reliable data on how much individual repair jobs should and do cost, DMIF managers cannot effectively (1) identify inefficiencies, (2) measure productivity, (3) determine staffing requirements, (4) evaluate workers' performance, or (5) ensure that customers are paying an appropriate amount for the services provided. This lack of reliable data will also make it difficult for DMIF managers to achieve the savings mandated by DMRD 908 and make it impossible to document the savings actually achieved.

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## DMIF's Data Problems Are Well Documented

During the last 2 years, we and the DOD Inspector General have reported on DMIF managers' need for better data on repair costs. For example, in January 1991, the DOD Inspector General reported<sup>2</sup> that DMIF managers did not have reliable estimates for how long workers should take to accomplish their work. The report disclosed that the labor standards<sup>3</sup> for 22 maintenance and repair operations involving six types of aircraft showed that these standards could be reduced by an average of 34 percent.

These labor standards are important to both DMIF and its customers. They are important to DMIF because managers use them not only to determine resource requirements but also as a benchmark by which to measure workers' performance. They are important to DMIF customers because they are used to develop DMIF sales prices. Based on these prices and an estimated level of required maintenance work, customers request appropriated funds to pay for the goods and services they receive from DMIF.

In February 1991, we reported<sup>4</sup> that DMIF managers also lacked reliable data on how much it actually costs to do a job. We attributed this problem to the facts that (1) DMIF accounting systems do not accumulate actual direct labor costs for individual jobs but instead estimate these costs by

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<sup>2</sup>Management of Labor Standards for Airframes at Aeronautical Depots (Report No. 91-039, January 31, 1991).

<sup>3</sup>Labor standards represent the time it takes a trained worker, working at a normal pace and under specific conditions, to produce a prescribed unit of acceptable quality work.

<sup>4</sup>Management letter to the AFMC Commander on the results of our audit of DMIF financial statements (GAO/AFMD-91-33ML, February 26, 1991).

allocating costs that are accumulated at the shop level, (2) the ALCs do not have effective controls to insure material costs are charged to the right job, and (3) DMIF's accounting systems do not allocate overhead costs properly.

This lack of reliable data on actual repair costs has many of the same adverse effects as inaccurate labor standards. For example, it makes it difficult for managers to identify inefficiencies, evaluate workers' performance, or measure productivity. Also, it makes it difficult to determine if customers are paying the proper amount for the services they are provided.

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### Workload Competitions Demonstrated the Magnitude of DMIF's Data Problems

The magnitude of DMIF's data problems was clearly demonstrated during the public/private sector competitions that were held in fiscal year 1991. At three of the five ALCs, the work the ALCs competed for during fiscal year 1991 was work that they had been doing previously and for which they, therefore, should have had reliable cost estimates. However, none of the ALCs used their cost accounting data and normal price setting procedures to develop their bids. For example, one ALC estimated that it used nearly 11 staff-years and incurred more than \$400,000 in salary, training, and supply costs to develop a bid on the repair of an item that, according to an ALC manager, had been repaired at the ALC for at least 20 years.

The ALCs' decisions not to use their cost accounting systems and normal price-setting procedures to develop their bids was a direct result of the type of data problems that we and the DOD Inspector General have recently reported. For example, in a lessons learned report that was submitted to AFMC Headquarters, an ALC noted that it deviated from its normal price setting procedures and cited the following as some of the reasons why this was necessary:

- "[AFMC] does not have a cost system in place that will track 'actual' hours to perform tasks. We have to rely on standards which may or may not be competitive."
- "Tracking material costs is difficult because materials are ordered against random [jobs] rather than the correct [one]. The [automated systems] provide accurate actual [material] cost data, but the systems are dependent on the material being ordered against the correct [job]."
- "[Shop] overhead rates should not be blended if we are going to operate in a competitive environment. Each [shop] should carry only the overhead required to support its operation."

An ALC manager provided further clarification. He told us that labor standards for in-house work not subject to competition were inflated because (1) labor efficiency is one of the key factors maintenance supervisors have been evaluated on in the past and (2) supervisors have inflated the labor standards to make themselves look good. Similarly, this official noted that material standards are also inflated because maintenance personnel are not confident that the supply system will have parts available when needed and, therefore, inflate their material standards so more parts will be stocked.

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**Audit Reports Identified  
Needed Corrective Action**

DOD Inspector General and our reports have identified needed corrective actions that, if taken, should improve the quality of DMIF's data. For example, the DOD Inspector General made specific recommendations to improve DMIF's procedures for establishing, reviewing, and updating its labor standards.

Similarly, in our report we suggested that the AFMC Commander direct the AFMC Deputy Chief of Staff/Maintenance to ensure that the problems we identified in DMIF's accounting system are resolved when DMIF's new management information system is implemented. In addition, we suggested that the AFMC Commander direct the ALC commanders to take various actions to improve their control over material.

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**Conclusions**

The Air Force's public/private sector competition program is unlikely to produce the projected level of savings, but it has served to highlight DMIF's lack of relevant and accurate data. To successfully compete with the private sector, DMIF managers will be forced to develop more reliable estimates of expected repair costs for the work loads that will be included in the program. However, effectively identifying and improving inefficient operations, and achieving the mandated savings will be highly dependent on DMIF managers' ability to generate reliable data on the expected and actual cost of all work loads, not just the 13 percent that is projected to

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eventually be subject to competition. We are reaffirming the actions proposed in previous GAO<sup>5</sup> and DOD Inspector General<sup>6</sup> reports for the Air Force to improve the accuracy of its cost data and standards and are not making any additional recommendations on these matters.

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<sup>5</sup>Management letter to the AFMC Commander on the results of our audit of DMIF financial statements (GAO/AFMD-91-33ML, February 26, 1991).

<sup>6</sup>Management of Labor Standards for Airframes at Aeronautical Depots (Report No. 91-039, January 31, 1991).



# DMIF Profits on Contracts Reviewed by GAO

Dollars in thousands

Contract	DMIF costs				Total cost	DMIF profit	
	DMIF revenue	Paid to contractor	Surcharge <sup>a</sup>	Government furnished material		Amount	Percent of total cost <sup>c</sup>
<b>Oklahoma City ALC</b>							
F3460185C2041	\$ 610.8	\$ 370.2	\$35.8	\$0	\$ 405.9 <sup>b</sup>	\$ 204.8	50.5
F3460185D0078	3,348.5	2,657.2	49.5	0	2,706.7	641.8	23.7
F3460185D3224	379.5	70.1	5.6	0	75.7	303.9 <sup>b</sup>	401.6
F3460186C0089	41.3	7.9	0.6	0	8.5	32.8	387.1
F3460187D1025	571.8	265.9	17.3	0	283.2	288.6	101.9
F3460188C1762	202.0	89.9	3.0	0	92.9	109.0 <sup>b</sup>	117.4
F3460189C2006	92.2	58.5	1.4	0	59.8 <sup>b</sup>	32.3 <sup>b</sup>	54.1
F3460190C0127	15.0	9.9	0.2	0	10.1	4.9	48.3
F3460190D0761	34.4	9.6	0.5	0	10.1	24.3	239.3
F3460191M0842	30.0	23.2	0.4	0	23.6	6.4	27.2

<sup>a</sup>The ALCs add a surcharge to the contract amount in order to cover contract administration costs.

<sup>b</sup>Does not total due to rounding.

<sup>c</sup>In determining the percentage, we used the actual total cost and profit instead of the figures rounded to thousands.

**Appendix I  
DMIF Profits on Contracts Reviewed by  
GAO**

Dollars in thousands

Contract	DMIF costs				Total cost	DMIF profit	
	DMIF revenue	Paid to contractor	Surcharge <sup>a</sup>	Government furnished material		Amount	Percent of total cost <sup>c</sup>
<b>Sacramento ALC</b>							
F0460689C0820	\$ 82.2	\$ 39.6	\$ 1.6	\$ 0	\$ 41.2	\$ 41.0	99.6
F0460689C0074	62.0	16.1	1.2	0	17.3	44.7	257.7
F0460690C0558	53.3	12.0	1.0	0	13.0	40.3	309.6
F0460687C1070	42.4	15.1	3.0	0	18.2 <sup>b</sup>	24.3 <sup>b</sup>	133.5
F0460685C1086	472.7	273.1	14.0	24.1	311.2	161.4 <sup>b</sup>	51.9
F0460690M3903	16.1	1.2	0.3	0	1.5	14.6	996.4
F0460685D0030	1,850.5	1,536.3	44.8	0	1,581.0 <sup>b</sup>	269.4 <sup>b</sup>	17.0
F0460683D0078	516.6	393.3	5.1	46.7	445.0 <sup>b</sup>	71.6	16.1
F3460183D3323	167.0	111.0	1.7	0	112.7	54.3	48.2
F0460690M1087	22.6	1.0	0.4	0	1.4	21.2	1,474.7

<sup>a</sup>The ALCs add a surcharge to the contract amount in order to cover contract administration costs.

<sup>b</sup>Does not total due to rounding.

<sup>c</sup>In determining the percentage, we used the actual total cost and profit instead of the figures rounded to thousands.

**Appendix I  
DMIF Profits on Contracts Reviewed by  
GAO**

Dollars in thousands

Contract	DMIF costs				Total cost	DMIF profit	
	DMIF revenue	Paid to contractor	Surcharge <sup>a</sup>	Government furnished material		Amount	Percent of total cost <sup>c</sup>
<b>Warner Robbins ALC</b>							
F41608800003	\$ 34.6	\$ 0	\$ 0.4	\$ 0	\$ 0.4	\$ 34.2	9,505.6
F0960389M2057	6.5	0	0.1	0	0.1	6.4	8,500.0
F0960386F0430	10.1	2.9	0.1	0	3.0	7.1	236.5
F0960389C0705	88.5	39.7	0.9	0	40.6	47.9	118.0
FD20609078731	27.4	11.1	0.3	0	11.3 <sup>b</sup>	16.1	142.2
F0561190MV747	4.7	1.5	0.1	0	1.5 <sup>b</sup>	3.2	213.2
F0960380G0001	586.1	381.4	5.4	0	386.8	199.3	51.5
F0960382D3442	703.7	630.5	6.9	5.1	642.6 <sup>b</sup>	61.1	9.5
FD20609078703	32.4	27.1	0.3	0	27.5 <sup>b</sup>	4.9	17.9
FD20609078702	870.5	738.0	8.7	0	746.7	123.8	16.6

<sup>a</sup>The ALCs add a surcharge to the contract amount in order to cover contract administration costs.

<sup>b</sup>Does not total due to rounding.

<sup>c</sup>In determining the percentage, we used the actual total cost and profit instead of the figures rounded to thousands.

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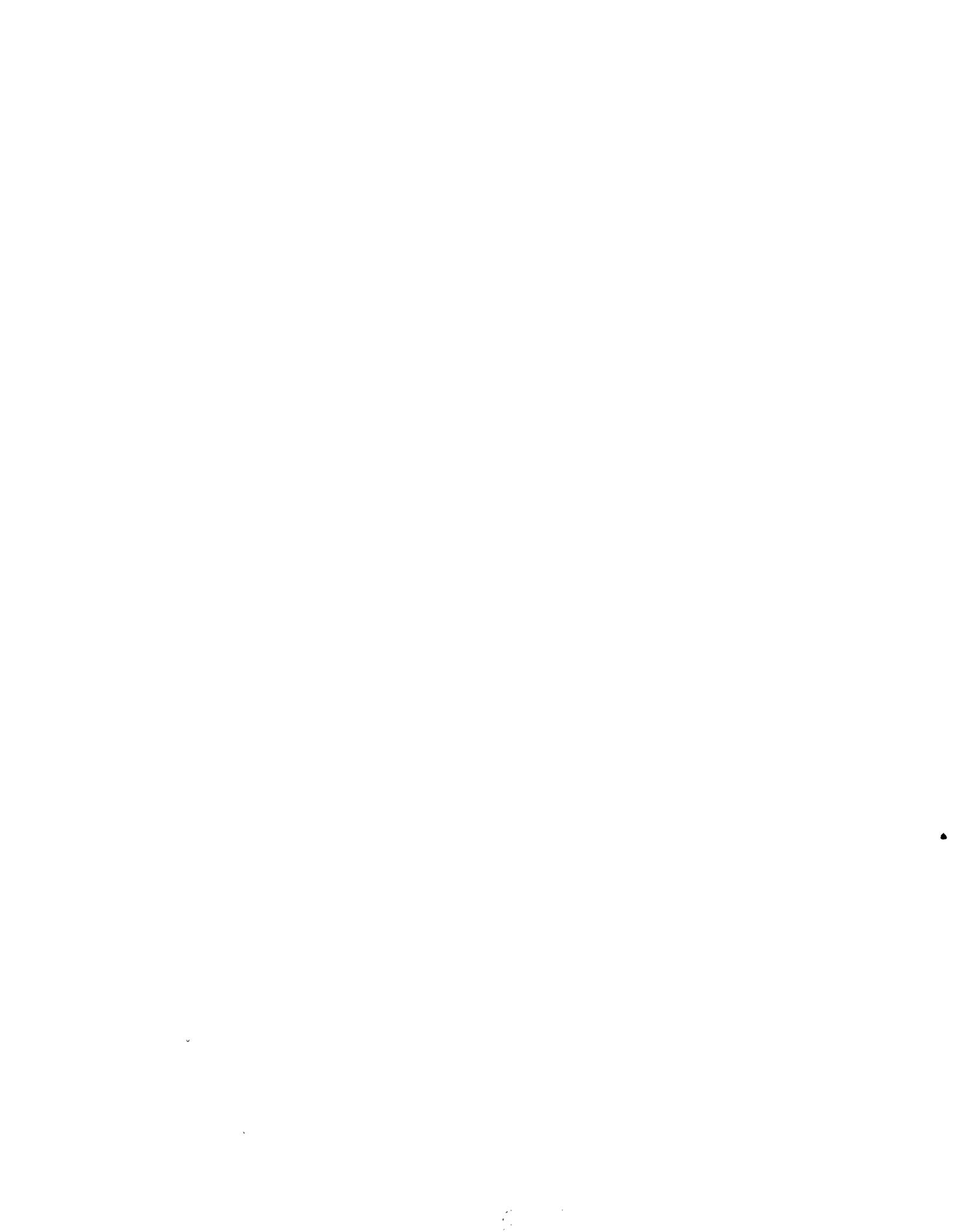
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